Indiana Department of State Revenue

Revenue Ruling #2001-09IT

September 11, 2001

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ISSUES

Gross Income Tax, Adjusted Gross Income Tax, Supplemental Net Income Tax, Sales/Use Tax and Payroll Taxes – Proposed Business Restructings

Authority: IC 6-2.1-3-25, Rule 45 IAC 1.1-1-3, Rule 45 IAC 1.1-2-13, IC 6-2.1-16, Tax Policy Directive # 2, IC 6-3-1-11, IC 6-2.5-2-1, IC 6-2.5-3-2, IC 6-2.5-4-1, IC 6-3-4-8

The taxpayer requests the Department to rule on various issues pertaining to two proposed business restructings. The specific issues will be listed and addressed in the "Discussion and Rulings" portion of this ruling.

STATEMENT OF FACTS

The taxpayer is commercially domiciled in Indiana with one current wholly owned subsidiary and a partial interest in two existing limited liability companies. The taxpayer is an agricultural cooperative and is a major supplier of farm inputs. The taxpayer is, also, a major supplier of motor fuels, heating fuels and motor oils to both commercial and residential customers.

The taxpayer is contemplating a business restructuring with two possible plans, i.e., proposal #1 and proposal #2. Under either proposal the taxpayer's subsidiary, sometime prior to the execution of the proposed restructuring, will be liquidated, tax-free into itself under IRC Section 332.

Under restructuring proposal #1 the taxpayer would contribute a 99% undivided interest in a substantial portion of assets and liabilities to SMLLC #1, a newly created single member LLC, in exchange for a 100% membership interest in SMLLC #1. The taxpayer would also contribute a 1% undivided interest in the identical assets and liabilities to SMLLC #2 in exchange for a 100% membership interest in SMLLC #2. As both SMLLC #1 and #2 are single member LLCs, disregarded as an entity separate from its owner under Federal Regulation 301.7701-3(b)(ii), the transfer would be affected in a tax-free manner. For federal income tax purposes the transfer is treated as a transfer from one

division of a company to another. No gain or loss is recognized and the assets will have a carryover basis.

SMLLC #1 and #2 will then both contribute their respective undivided interests in the taxpayer's assets and liabilities to a limited partnership (LP). SMLLC #1 will receive a 99% limited or general partnership interest and SMLLC #2 will receive a 1% general or limited partnership interest in exchange for the assets contributed.

For federal income tax purposes income or loss earned by the LP will be treated as if the taxpayer earned it. This is the case because both SMLLCs are disregarded entities for federal income tax purposes, e.g., they are treated as branches of the taxpayer. For federal income tax purposes, the LP would, therefore, be treated as if it were solely owned by the taxpayer and also disregarded as an entity separate from its owner under Regulation 301.7701-3(b)(ii). Thus, for federal income tax purposes the income or loss of the LP would be included as a part of the taxpayer's federal taxable income.

Under restructuring proposal #2 the taxpayer would contribute a 99% undivided interest in a substantial portion of assets and liabilities to SMLLC #1, a newly created single member LLC, in exchange for a 100% membership interest in SMLLC #1. As SMLLC #1 is single member LLC and is disregarded as an entity separate from its owner under Federal Regulation 301.7701-3(b)(ii), the transfer would be affected in a tax-free manner. For federal income tax purposes the transfer is treated as a transfer from one division of a company to another. No gain or loss is recognized and the assets will have a carryover basis.

SMLLC #1 will then contribute its 99% undivided interest in the taxpayer's assets and liabilities to a newly formed Limited Partnership (LP) in exchange for a 99% limited or general partnership interest. The taxpayer will then contribute the remaining 1% undivided interest in the identical assets directly to the LP in exchange for a 1% general or limited partnership interest. Under the provisions of Federal Regulation 301.7701-3(b)(ii), the LP will then become an entity with a single owner, and will be disregarded as an entity separate from its owner. Thus, for federal income tax purposes income or loss earned by the LP will be treated as if the taxpayer earned it.

DISCUSSION AND RULINGS

ISSUES:

1. Will IDOR recognize the existence of the LP as a partnership for Gross Income Tax (GIT) purposes for both proposed Restructurings #1 and #2, described above?

   The Department recognizes the existence of the LP for gross income tax purposes for both proposal #1 and proposal #2 to the extent the partnership is created pursuant to all Indiana applicable statutes.

2. Will the LP be subject to GIT in either of the proposed restructurings?

The Department rules that the LP will not be subject to gross income tax in either of the proposals to the extent the LP is not a publicly traded partnership that is treated as a corporation for federal income tax purposes under Section 7704 of the Internal Revenue Code as provided by IC 6-2.1-3-25.

3. If the LP is treated as a partnership for GIT for both proposed restructurings, will the net income earned by the LP be treated as a dividend from the limited partnership and as an apportioned, using the equally weighted three-factor formula, partnership distribution from the general partner, respectively, to the taxpayer and be subject to GIT at the taxpayer level at the 1.2% GIT rate?

   The Department rules that, pursuant to Rule 45 IAC 1.1-1-3, distributions from the limited partner are taxed 100% to the taxpayer at the rate of 1.2%. Pursuant to Rule 45 IAC 1.1-2-13, distributions from the general partner are apportioned, if applicable, and taxed at the rate of 1.2% at the taxpayer's level.

4. As presented in Issue #2, will the two SMLLCs in proposed restructuring #1 and the one SMLLC in proposed restructuring #2, be treated as disregarded entities, non-taxpayers or pass through entities not subject to GIT?

   Pursuant to IC 6-2.1-1-16, limited liability companies that have a single member and are disregarded as entities for federal income tax purposes are not defined as gross income tax "taxpayers". Further, Departmental Tax Policy Directive #2 provides that for Indiana income tax purposes LLCs are treated the same as they are for federal income tax purposes. The Department rules, therefore, that the SMLLCs are both, not defined as gross income taxpayers and are disregarded entities for gross income tax, hence, are not subject to gross income tax.

5. If the LP was not treated as a partnership for GIT purposes, how will it be treated and what are the GIT consequences for both proposed restructurings?

   The Department rules that, as discussed in issue #1, the LP will be treated as such for gross income tax purposes.

6. For Indiana Adjusted Gross Income Tax (AGIT) and Supplemental Net Income Tax (SNIT) will the existence of the SMLLCs and the LP follow federal income tax treatment and be disregarded? The result being that for AGIT and SNIT the taxpayer's taxable income will include all the income or loss, subject to apportionment, of all the entities described in the two proposed restructurings, e.g., the entire respective group of entities in both proposed restructuring scenarios would be treated as single entitles?

   Pursuant to IC 6-3-1-3.5, the departure point for calculation of the Indiana adjusted gross income tax and the supplemental net income tax for corporations is IRC Section 63 "taxable income". This being the case the Department rules that, to the extent the SMLLCs and the LP are treated as disregarded entities for federal

income tax purposes, the taxpayer's adjusted gross income tax and supplemental net income tax "taxable income" will include all income or loss, subject to apportionment, of all entities described in proposal #1 and proposal #2, e.g., each respective group of entities in proposal #1 and proposal #2 will be treated as single entities.

7. As the taxpayer is an agricultural cooperative, eligible to deduct patronage dividends under Subchapter T of the Internal Revenue Code (IRC), would any of the scenarios described above inhibit in any way the taxpayer's ability to take a full patronage dividend deduction for AGIT and SNIT purposes?

   The Department rules that, to the extent the taxpayer is eligible to deduct patronage dividends for federal income tax purposes, the creation of the SMLLCs and LP would not inhibit the taxpayer's ability to take a full patronage dividend deduction for Indiana adjusted gross income tax and supplemental net income tax purposes as provided by IC 6-3-1-11.

8. Does the fact that the taxpayer is an agricultural cooperative for federal income tax purposes affect the answer to questions 1 through 6 above in any way?

   The Department rules that the fact the taxpayer is an agricultural cooperative for federal income tax purposes does not affect the answers to the above issues #1 through #6 as Indiana uses the IRC Section 63 "taxable income" as the starting point for the calculation of Indiana corporate adjusted gross income tax and supplemental net income tax.

9. Are there any sales or use taxes due on the transfer of vehicles and other assets from the taxpayer to the SMLLCs or the LP in either of the proposed restructurings?

   IC 6-2.5-2-1 and IC 6-2.5-3-2 impose sales/use tax on retail transactions made in Indiana and on tangible personal property stored, used or consumed in Indiana that was acquired in a retail transaction. IC 6-2.5-4-1 provides that a "retail transaction" is defined as the transfer of tangible personal property for consideration. The Department rules then, that to the extent that the transfer of vehicles and other assets from the taxpayer to the SMLLCs and the LP is not a taxable event for federal income tax purposes there is no consideration involved in the transfer, therefore, no retail transaction is executed and no sales/use tax is due on the transfer of vehicles and other assets in proposal #1 or proposal #2.

10. For Indiana individual income tax withholding purposes will the taxpayer or the LP be treated as the employer following the restructuring? If the taxpayer is not treated as the employer, will the taxpayer and the LP have to file separate W-2s and W-3s and other related payroll tax reports?

    IC 6-3-4-8 states that every employer making payments of wages subject to tax under IC 6-3 who is required under the provisions of the Internal Revenue Code to withhold, collect and pay over income tax on wages paid by such employer to such

employee, shall, at the time of payment of such wages, deduct and retain therefrom the amount prescribed in the withholding instructions issued by the Department. It is clear then, every employer who is required under the provisions of the Internal Revenue Code to withhold, collect and pay over federal income tax on wages paid by the employer is required, also, to withhold Indiana state and county tax (if applicable) on these wages. The Department rules, therefore, that to the extent the taxpayer and/or the LP are required to withhold federal income tax on wages paid, the taxpayer and/or the LP are required to, also, withhold Indiana state and county tax (if applicable) on these wages.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated herein, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling, changes in statute, a regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

INDIANA DEPARTMENT OF REVENUE